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No. 521

In the Supreme Court of the United States

OCTOBER TERM, 1952

CENTRAL BANK, A CORPORATION, *Petitioner*

v.

THE UNITED STATES

On Petition for a Writ of Certiorari to the United States Court of Claims

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BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINION BELOW

The opinion of the Court of Claims (R. 75-79) is reported at 105 F. Supp. 992.

JURISDICTION

The judgment of the Court of Claims (R. 79) was entered on July 15, 1952. A motion for a new

trial was filed August 13, 1952, and was overruled October 7, 1952. (R. 79.) The petition for a writ of certiorari was filed December 30, 1952. The jurisdiction of this Court is invoked under 28 U.S.C., Sec. 1255(1).

QUESTION PRESENTED

Payments under a Navy contract were assigned by the contractor to petitioner under R. S. 3477 and 3737, as amended. The contract provided that payments thereunder to an assignee should not be subject to reduction or set-off for indebtedness of the assignor to the United States arising independently of the contract. The contractor in the performance of the contract withheld from the wages and salaries of its employees appropriate amounts to cover their income and social security taxes, but failed to pay such amounts over to the Government. The Comptroller General declined to authorize payment to the assignee of the final amount due from the United States under the contract, but instead set off that amount against the taxes withheld but not paid by the contractor, on the ground that the Government's claim for said taxes did not arise independently of the contract.

The question presented is whether the United States could legally make the set-off as against the assignee.

STATUTES INVOLVED

The applicable statutes are set forth in the Appendix, *infra*, pp. 15-18.

STATEMENT

The special findings of fact of the Court of Claims (R. 73-75) may be summarized as follows:

Petitioner, a California corporation, was during the years involved, and is now, engaged in the banking business. (R. 73.)

On December 30, 1944, the Graham Ship Repair Company (hereinafter sometimes referred to as "Graham") a partnership having its place of business in Oakland, California, entered into a contract with the Navy Department of the United States for certain ship repair work. After the execution of such contract, Graham arranged with petitioner for the financing of the work to be performed under the contract and as security for the funds to be advanced assigned to petitioner the proceeds payable under the contract. This assignment was made pursuant to the provisions of R.S. 3477 and 3737, as amended by the Assignment of Claims Act, 54 Stat. 1029, 31 U.S.C. 203; 41 U.S.C. 15, *infra*, pp. 16-18. The Contracting Officer, Bureau of Ships, Navy Department, the Disbursing Officer and the General Accounting Office were duly notified of the assignment as required by the Act. (R. 73.)

After the execution of the assignment, petitioner advanced to Graham substantial sums of money for use in the performance of the contract. During the course of the performance of the contract, certain administrative officers of the Government ascertained that the contractor had failed to pay over and remit to the Collector of Internal Revenue sums of $453,469.55, representing withholding taxes, and $11,462.91, representing federal unemployment taxes, which the contractor had withheld from salaries and wages of its employees engaged in the performance of the Navy contract. Sections 1401 and 1622 of the Internal Revenue Code required Graham as an employer to make these withholdings, but instead of paying over those amounts to the Collector of Internal Revenue the contractor converted them to its own use. Because of this dereliction on the part of the contractor, no further job orders were issued to it under the contract after March 31, 1946, and the contract was terminated. The individuals composing the Graham Ship Repair Company partnership were indicted in the United States District Court for the Northern District of California, Southern Division, under Section 2707(c) of the Internal Revenue Code (26 U.S.C. 2707(c)), for willful attempt to evade and defeat the payment of the withheld taxes, and they entered pleas of guilty to the charge. (R. 73-74.)

At the time the contract was terminated, Graham

was indebted to the Government for the unpaid withholding taxes above referred to, which with interest and penalties aggregated $616,750.95. At that time, the sum of $110,966.08 was due Graham, the contractor, for work performed under the contract. Also at that time, Graham was indebted to petitioner in an amount in excess of $110,966.08, for advances made by petitioner pursuant to the assignment. (R. 74.)

Because of the outstanding taxes due from Graham, the Commissioner of Internal Revenue filed a claim with the Navy Department for the balance due under the contract, and since petitioner also claimed such balance under the assignment agreement, the conflicting claims were referred by the Navy Department to the General Accounting Office for direct settlement. (R. 74.)

By decision dated May 18, 1950, the Comptroller General of the United States ruled that the sum of $110,966.08 due Graham was a proper set-off against the taxes due from Graham, and that official therefore denied petitioner's claim. Thereafter, by the issuance of appropriate certificates of settlement, the Comptroller General effected the set-off, thereby reducing the tax indebtedness of Graham to $415,018.17, which for purposes of this case the petitioner admits is still outstanding and unsatisfied. In December 1946, the Commissioner of Internal Revenue made appropriate assessments of the taxes

due from Graham and thereafter, in December 1946, the Collector of Internal Revenue at San Francisco filed liens against that taxpayer for such taxes, which liens were duly recorded. (R. 74-75.)

The Court of Claims rendered judgment for the United States, holding that the set-off made by the Comptroller General was legal and proper and that petitioner was not, therefore, entitled to recover under the assignment (R. 75-79).

ARGUMENT

The precise question presented is whether the tax debt due from the contractor to the United States arose independently of its contract with the Navy, within the meaning of the following provision of the Assignment of Claims Act of 1940, *infra*, p. 18:

> Any contract entered into by the War Department or the Navy Department may provide that payments to an assignee of any claim arising under such contract shall not be subject to reduction or set-off, and if it is so provided in such contract, such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of such contract.

1. Petitioner contends (Pet. 9-10) that the tax debt had no relation to the Navy's contract with its assignor, but arose independently of that contract. The contention is without merit.

The court below found (R. 73) that the tax debt of the contractor arose because of its failure to pay over to the Collector of Internal Revenue certain amounts which it had withheld from the salaries and wages of its employees who were engaged in the performance of the Navy contract from which petitioner's assignment derived. Thus, it is beyond question that the tax obligation depended for its existence upon the contract, for if there had been no contract, no taxes would have become due and no liability would have accrued. There is, of course, no question here of an allocation of the taxes with respect to employees who worked on other contracts either all or part of the time. Hence, the taxes were not only related to the particular Navy contract but they owed their existence to it.

Petitioner contends (Pet. 6, 9-10) that the contractor's debt for taxes grew out of the criminal embezzlement of the funds withheld from its employees, and that it was not therefore a contract indebtedness. This contention ignores the fact that no obligation arose under the pertinent taxing statutes until services were performed under the contract and salaries and wages were paid for such services. It was not until the salaries and wages were due for services performed that any obligation devolved upon the contractor to withhold a portion of the amounts due. The contract could not have been performed without giving

rise to the very debt now in question, and the conclusion appears inescapable that the tax debt did not arise independently of such contract. Hence, the tax obligation did not arise out of the embezzlement by the contractor of the tax funds but came into existence by reason of the impact of the taxing provisions upon the performance of the contract. While the failure of the contractor to satisfy the tax obligation became a conversion, the withholding tax obligation had arisen before the conversion and was directly dependent upon the performance of the contract. The fact that the failure of the partnership contractor to pay over to the Government the withholding taxes subjected the members of that partnership to criminal liability for which they were duly tried and convicted, plainly has nothing whatever to do with the question whether the obligation to pay over to the Government the sums withheld from the employees who worked on the contract, arose out of the contract.

The decision of the court below is in accord with the provisions of the Assignment of Claims Act of 1940, *infra*, pp. 16-18, which permit the assignment of the proceeds of Government contracts within certain limitations.

Prior to the enactment of the Assignment of Claims Act, all assignments of claims against the United States (with exceptions not here material) were declared by statute to be null and void.

Sections 3477 and 3737, Revised Statutes (*infra*, pp. 15-16). However, in 1940 Congress became aware of the fact that the application and enforcement of these restrictive provisions would be prejudicial to the defense effort and a bill was introduced in Congress (H.R. 10464, 76th Cong., 3d Sess.) amending those sections to permit the assignment of the proceeds of a Government contract to a bank, trust company or financing institution, including any federal lending agency, as security for advances or loans to aid in the performance of a contract. During the debate on the bill in the Senate, an amendment to the bill was offered by Senator Barkley, which later became, in substantially the same language, the paragraph of the Assignment of Claims Act of 1940, quoted above (*supra*, p. 6) and which precluded the Government from making set-offs of claims arising independently of the contract involved as against an assignee. Senator Barkley explained that the purpose of his amendment was to assist in the defense program by permitting contractors —particularly small contractors—to obtain funds with which to perform Government contracts and assign the proceeds of the contracts as security for loans. The Senator said in part (86 Cong. Rec., p. 12803):

> * * * it shall not be permissible to offset against the claim or contract later an indebtedness which the contractor may owe the

Government on account of some other contract or some other situation.

It is plain, therefore, from the legislative history of Senator Barkley's amendment that the restriction on set-offs against assignees was intended to apply only in connection with "some other contract or some other situation," or as the Senator further explained (also at 86 Cong. Rec., p. 12803), "something which had no relationship to the contract or to the defense program." In sum, the restriction placed on the Government by the amendment is limited strictly to claims which have no relationship whatever to the pertinent contract. The court below has so applied the provision in its prior decisions. See *Modern Industrial Bank* v. *United States*, 101 C. Cls. 808; *Royal Indemnity Co.* v. *United States*, 117 C. Cls. 736; and *Rhode Island Discount Co.* v. *United States*, 118 C. Cls. 262.

2. Petitioner's reliance upon the general law of assignments and the equities of the situation is misplaced. Neither of these doctrines supports its position in this case. The assignment here involved was made pursuant to an exception from the general provisions of R. S. 3477 and 3737, as amended by the Assignment of Claims Act of 1940, *infra*, pp. 16-18, without which exception the assignment would have been null and void. The reach of the assignment is therefore subject to the

limitations prescribed by the Amendatory Act which authorized the assignment and gave validity to it. In the circumstances, petitioner must accept all of the provisions of that Act, including the provision which protects the assignee against set-offs only in connection with claims that arise apart from and independently of the particular contract.

So far as the general law of assignments is concerned, the Government clearly did not exceed its rights in refusing to pay the assignee in this case. The Government was not a mere stakeholder but was the owner of the fund to be disbursed, and there was a debt due it from the contractor. Hence, it had a clear right to set off amounts due it against amounts which it owes. *United States* v. *Munsey Trust Co.*, 332 U.S. 234, 239. As this Court said in that case (p. 240), a creditor in the position of the Government in this case "is the best secured of creditors; his security is his own justified refusal to pay what he owes until he is paid what is due him."

With respect to the equities of the situation, the Government has merely enforced the provisions of the contract which the Gover. ment entered into with the contractor. Article 15(c) of the contract provides that (R. 35):

> Payments to an assignee of any claims arising under this contract shall not be sub-

> ject to reduction or set-off for any indebtedness of the Contractor to the Government arising independently of this contract.

In view of the foregoing provision of the contract, the petitioner must have realized that any amounts to which it should be entitled as assignee would be subject to invasion for any debts of the contractor to the Government arising in connection with the performance of the contract. And since, as we have shown (*supra*, pp. 7-8), the debt of the contractor was directly connected with the performance of the contract, petitioner has no cause for complaining that it has been unfairly treated by the Government.

Petitioner is in no worse position than a surety who has been obliged to pay laborers and materialmen because of the contractor's default. In such a case, the right of the Government to offset the contract balance against taxes due from the contractor is definitely established, notwithstanding any equities in favor of the surety. *United States* v. *Munsey Trust Co.*, 332 U.S. 234; *Schmoll, Successor* v. *United States*, 105 C. Cls. 415.

It is axiomatic that an assignee has no greater rights than those of the assignor and, therefore, were it not for the specific restriction in the Assignment of Claims Act of 1940, the Government would undoubtedly have the power to set off any debt due to it by the contractor of whatever character and however it arose, as against sums

due the assignee. But this Act limits such set-offs to indebtedness relating to the contract, and it is from this provision alone that the assignee may have protection against that general right.

It was implicit in the assignment in the instant case that the assignee should receive only those sums under the contract to which the contractor would be entitled, giving due effect, of course, to the restrictive provisions of the Assignment of Claims Act. Therefore, since the contractor would not have been entitled to the sum here sought because of tax indebtedness to the Government and because indebtedness did not arise independently of the contract but was directly related thereto, the petitioner is not entitled to recover.

CONCLUSION

The decision of the Court of Claims is correct, there is no conflict of decisions, and the case does not warrant further review. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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FEBRUARY, 1953.

APPENDIX

Revised Statutes:

SEC. 3477. All transfers and assignments made of any claim upon the United States, or of any part or share thereof, or interest therein, whether absolute or conditional, and whatever may be the consideration therefor, and all powers of attorney, orders, or other authorities for receiving payment of any such claim, or of any part or share thereof, shall be absolutely null and void, unless they are freely made and executed in the presence of at least two attesting witnesses, after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof. Such transfers, assignments, and powers of attorney, must recite the warrant for payment, and must be acknowledged by the person making them, before an officer having authority to take acknowledgements of deeds, and shall be certified by the officer; and it must appear by the certificate that the officer, at the time of the acknowledgement, read and fully explained the transfer, assignment, or warrant of attorney to the person acknowledging the same. * * *

(31 U.S.C. 1946 ed., Sec. 203.)

SEC. 3737. No contract or order, or any interest therein, shall be transferred by the party to whom such contract or order is given to any other party, and any such transfer shall cause the annulment of the contract or order transferred, so far as the United States are concerned. All rights of action, however, for any breach of such contract by the contracting parties, are reserved to the United States.

(41 U.S.C. 1946 ed., Sec. 15.)

Assignment of Claims Act of 1940, c. 779, 54 Stat. 1029.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That sections 3477 and 3737 of the Revised Statutes be amended by adding at the end of each such section the following new paragraph:

"The provisions of the preceding paragraph shall not apply in any case in which the moneys due or to become due from the United States or from any agency or department thereof, under a contract providing for payments aggregating $1,000 or more, are assigned to a bank, trust company, or other financing institution, including any Federal lending agency: *Provided,*

"1. That in the case of any contract entered into prior to the date of approval of the Assignment of Claims Act of 1940, no claim shall be assigned without the consent of the head of the department or agency concerned;

"2. That in the case of any contract entered into after the date of approval of the Assignment of Claims Act of 1940, no claim shall be assigned if it arises under a contract which forbids such assignment;

"3. That unless otherwise expressly permitted by such contract any such assignment shall cover all amounts payable under such contract and not already paid, shall not be made to more than one party, and shall not be subject to further assignment, except that any such assignment may be made to one party as agent or trustee for two or more parties participating in such financing;

"4. That in the event of any such assignment, the assignee thereof shall file written notice of the assignment together with a true copy of the instrument of assignment with—

"(a) the General Accounting Office,

"(b) the contracting officer or the head of his department or agency,

"(c) the surety or sureties upon the bond or bonds, if any, in connection with such contract, and

"(d) the disbursing officer, if any, designated in such contract to make payment.

Notwithstanding any law to the contrary governing the validity of assignments, any assignment pursuant to the Assignment of Claims Act of 1940 shall constitute a valid assignment for all purposes."

Any contract entered into by the War Department or the Navy Department may provide that payments to an assignee of any claim arising under such contract shall not be subject to reduction or set-off, and if it is so provided in such contract, such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of such contract.

* * * *

(31 U.S.C. 203; 41 U.S.C. 15.)

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